

Recommendations

of The Canadian Council for Public-Private Partnerships

presented to the
Walkerton Inquiry
Part 2: Public Meeting
Management of Water Providers
September 20, 2001

Presentation by: Hon. Michael H. Wilson,
Chair, CCPPP

The Canadian Council for Public - Private Partnerships (CCPPP) Interest in the Walkerton Inquiry

First and foremost, CCPPP has an interest in seeing infrastructure and service investments keep pace with the needs of its citizens. The tragedy in Walkerton in 2000 has focused our collective attention on the state of water related infrastructure in this province and on the methods of delivery. CCPPP's first interest is ensuring that all options are explored in that regard.

Secondly, we recognize that it is an increasingly globalized environment within which all Canadians live and that for Canada to be competitive, it must constantly upgrade its public services and infrastructure to attract business investments.

CCPPP believes that the capacity of the public sector to meet the accumulative infrastructure requirements in all sectors is limited and that the instrument of public-private partnerships is one method of bridging the gap between public sector capacity and the demands being placed upon it. Our position is reinforced by our exposure to other government-led programs, most notably the United Kingdom, Australia and New Zealand and increasingly in the EU countries which support the concept of public-private partnerships and the modernization of their infrastructure through a variety of such arrangements. South Africa is also well into the development of a similar program.

CCPPP's intention is to bring forward to the Inquiry options in the provision of water services to those traditionally offered directly by municipal organizations either through public departments or agencies and public utility commissions. The nature of the arrangements that we support are public-private partnerships rather than privatization.

Our Mandate

The Canadian Council for Public-Private Partnerships is supported by membership fees and revenues generated through events and research publications. No direct government grants are received to support our operations although research activity is often undertaken through partnerships with government organizations. CCPPP works on a national platform and draws members in almost equal numbers from the public and private sectors. We work very closely with governments across Canada and support them through the provision of expert advice and research materials. The CCPPP Board of Directors is made up both of public and private senior representatives as well as union representation.

With interest in the particular issues before the commission would be our members representing the following:

- Municipalities, some with private operators, many looking at it as an option.
- Provincial governments throughout Canada
- Engineering and technical consultants both to public and private clients
- Private water companies

- Construction companies
- Management consultants working in the environmental field as advisors to both public and private sectors
- Financial and legal advisors to both sectors

Background

CCPPP has been involved in the Inquiry in a number of ways:

In January 2001, CCPPP submitted a report to the Inquiry entitled "A Submission to the Walkerton Inquiry (Part II) Concerning Alternative Models of Water Systems with Private Sector Involvement". A companion document entitled "Overview of Successful Public-Private Partnerships in the Water Sector" accompanied the submission. The former is posted on the Inquiry's website for viewing. The latter is a very important piece of research conducted by CCPPP which examined nine North American water and wastewater projects looking at financial savings to the municipalities, public satisfaction with the private sector operations taking into account such considerations as the impact on water rates, quality of service and so forth. Each project carries a testimonial from either an elected representative or a senior works commissioner with direct knowledge of the individual project's performance. This publication is not posted on the website for technical reasons but is critical to appreciating the position of CCPPP.

Appearances were also made at the technical meetings of June 20 and July 5. In addition to technical advisors, CCPPP was accompanied to the meetings by Mayor Brian Murphy and City Manager Al Strang, City of Moncton (June 20 Meeting) and Mayor Deb Shewfelt, Town of Goderich (July 5), who shared the experiences of their respective communities in public-private partnerships in water delivery.

In addition, CCPPP sought the input of Ofwat (Office of Water Services) in the United Kingdom to comment on the CUPE commissioned report on the UK Water Privatization recognizing that certain errors were presented within the Hall report and required correction and clarification. As the economic regulator of privatized water services in the UK, only Ofwat could accurately identify misrepresentations or misinterpretations within the report. The response provided by Director General Philip Fletcher appears on the Inquiry website as a communication between him and the Executive Director of CCPPP. Again, this is a valuable contribution to the understanding of how effectively the private sector has been involved in the provision of water services.

The CCPPP position on all matters related to the development of a future water delivery system for Ontario are captured in those various documents and summaries of discussion. Our purpose by way of this submission is not to revisit the detail of those individual documents. Rather our intention is to offer some concluding thoughts based on our research and technical knowledge of private sector operations in the water field.

Sound System of Water Delivery

The overall objective is first and foremost to achieve a sound water delivery system, one in which all factors contributing to the achievement of that system are free from influence or conflict that could potentially negatively affect overall performance of the system. Ensuring that all the components that have to interlock are in place is the first goal: the setting of water quality standards, non-performance detection responsibilities, enforcement capabilities, etc. All of these should be in place regardless of whether a private or public model of delivery is contemplated.

Within that context, we think there are a number of considerations to ensure the integrity of any system. These relate to the division of responsibility in the establishment of water quality standards & regulations, the enforcement of the standards, the financing of water systems and the elimination of conflicts with water treatment and delivery.

A great deal of discussion has already taken place throughout the hearings into these matters and carefully considered by experts advising the Commission. We, therefore, want only to reinforce the position that separation of each of these activities is warranted. Integrity of the system can only be achieved when conflicts of interest are removed such that each activity functions with clear objectives unfettered by extraneous considerations achieving other unrelated goals.

Water quality standards should be established to ensure safe potable water is available to our citizens. Supportable standards should not be compromised because of the recognized costs to achieve the standards. Performance of all systems should be monitored, whether public or private. Violations should be identified and violators dealt with fairly and consistently. Complications arising when the regulator is also the operator need to be eliminated. Similarly, the decision to set standards or enforce standards cannot be conflicted by the obligation to fund the upgrade to equipment or service to achieve the standards. When all these functions reside within the government or in an agency of the government, the potential for conflicts exist.

These are matters outside of the mandate of our Council and therefore our comments are offered only as observations rather than recommendations.

Public-Private Partnerships as an Option

The Canadian Council is, however, very well positioned to comment on the benefits that we have seen when public - private partnership models for delivery are utilized. It is our intent to offer assistance to the Inquiry as it looks to solutions in creating a future sound water delivery system in this province.

A commissioned paper of the Inquiry prepared by Professor David Cameron of the University of Toronto explored the relationship of ownership and operations and performance. He concluded that actual ownership as a characteristic itself appeared to be relatively unimportant in the achievement of good water quality. Rather, other factors such as "the skills and training of the

staff, the overall management systems that have been put in place, the state of development of water engineering and water technologies, the condition of the infrastructure, the existence of effective monitoring capability and adequate feed-back loops” are the factors that determine the quality of water being delivered to citizens in any given jurisdiction.

This finding supports much of our own research. For those matters within the scope of operations and physical assets, we believe that the achievement of a sound system is very much dependent upon the ability to finance the physical plant for water treatment and distribution systems and on the availability of highly trained staff with access to state of the art technology and innovation to operate it.

The Canadian Council for Public-Private Partnerships would suggest that there are factors influencing private sector organizations that compel them to consider the above characteristics somewhat differently than a public sector organization would. Based upon our research and upon our considerations of those factors which reflect some of the influences and drivers of private versus public businesses, we believe that there is a clear role for the private sector to play in the achievement of a sound water deliver system for Ontario and we, therefore, make one recommendation to the Inquiry:

RECOMMENDATIONS

That the Walkerton Inquiry recognize the benefits that can be derived from public-private partnerships in the water sector through the private sector’s participation in a spectrum of activities including finance, design, build and operation of water treatment facilities and distribution networks.

That the Walkerton Inquiry include within its recommendations to the Government of Ontario the increased reliance on public-private partnerships as an option to public sector delivery.

Financing

One of the areas in which the private sector has made the greatest impact is in the actual financing of water infrastructure. As Dr. W. H. Emery, Director General of Ofwat points out in his letter (July 18, 2001) on the modernization of the British water and wastewater system, between 1990 and 1999 capital investment made by the private sector to deliver higher water quality and sewage treatment standards set both nationally and at a European level, was close to £ 33 billion (May 1999 prices). By 2005 that investment is projected to be in excess of £50 billion. This level of investment was not remotely within the ability of the public sector and most would agree that the private sector is responsible for the modernization of a deteriorated public system in that country.

Within the Canadian context, we have seen the partnering of the public and private sectors solve a long time problem in Moncton, New Brunswick. Mayor Brian Murphy and City Manager Al Strang accompanied CCPPP to the June 20 Inquiry meeting to discuss their experience. For

many years Moncton chlorinated its water supply but did not meet the Canadian water quality guidelines for drinking water. Boil water orders were becoming increasingly common. Citizens in random sample surveys consistently recognized low water quality as the leading municipal service issue.

In 1995 they estimated a cost of \$32 million to provide a solution by way of a new treatment plant. They did not have the financial capacity to undertake the project and the future did not suggest that they would any time soon. They turned to the private sector through a competitive proposal process to develop a partnership with a private sector partner. In 1999 a new plant was up and running in Moncton delivering one of the highest water quality standards in this country. For \$23 million (\$11 million less than if delivered traditionally by the public sector) a private company had entered into a public - private partnership (Design Build Finance Operate) with a 20 year lease-license agreement with the full operation of the plant provided by the private sector. Water rates are established by the public sector. Regulations are imposed by the public sector.

This has been such a success and solved such a critical problem for the municipality that they are currently examining the feasibility of turning the refurbishment of the aged distribution system (some parts of which are 122 years old) to the private sector with an estimated private sector investment required of \$70 million.

Many other examples can be drawn from across North America and Europe as developed nations and clearly public - private partnerships are a standard instrument in achieving infrastructure investment and operations in developing countries, becoming almost the exclusive method used now in World Bank projects.

No comprehensive study has been completed to date to accurately reflect the infrastructure investment deficit and the future requirements in water and wastewater systems across Canada. Such a study is needed because it will help to focus the discussion. However, a study conducted by the Federation of Canadian Municipalities in 1996 estimated the investment deficit at \$44 billion for water supply services and \$9 billion for sewage treatment in Canada. It could be reasonably expected that these figures would be higher today.

CCPPP does not believe that the public finance capability in Ontario and certainly across Canada can address this infrastructure and service investment deficit and future requirements using government sources alone. In water and wastewater services, we question the accuracy of any studies that suggest Ontario municipalities currently have the financial capacity to address this investment deficit recognizing that the full costs to do so have not yet been determined.

Operations

The private sector has most commonly established itself across North America as operators of water and wastewater treatment facilities. This is gaining in popularity in the USA and observers of this particular industry report that more and more municipalities are exploring public - private partnerships as an alternative to traditional public sector operations. An

indication that satisfaction is being achieved is the high level of contract renewals that are being signed.

Many North American municipalities have found the public - private model of delivery better meets its obligations to operate a highly efficient and technically sound water treatment and wastewater systems than their traditional model of delivery. In terms of cost efficiencies alone, estimates by consultants working in this field are reporting savings in the range of between 30% and 40% over traditional public sector deliver.

Why are the efficiencies achieved by the private sector so great and how is it possible?

The benefits of using the private sector are explained in detail in the CCPPP January 2001 submission to the Inquiry. However, briefly, CCPPP believes there are a number of characteristics of private sector operations, as mentioned above, that position them to focus on efficiency and risk reduction which ultimately produces sound delivery systems. The first of these characteristics relates somewhat broadly to the nature of private enterprise in general but also specifically to private water companies.

Non-performing water companies fail to thrive. There is no such thing as a second chance when a water company fails to perform. They go out of business. There is no tolerance for error when it comes to the delivery of safe drinking water - either internally within the company or externally from the clients. Water companies want to survive. Everything within the company is designed to ensure that they continue to survive. And it starts at the top with their governance structures.

Municipally run water and wastewater facilities are most commonly overseen by some type of body made up of political appointees or the political representatives of the municipality - through a committee structure and Council or formally, through a public utility board. They are people elected to oversee the vast number of activities being performed by their municipal organizations or boards, being experts often in no individual area. Typically those represented on the oversight bodies have no technical background in water systems.

This stands in sharp contract to the management boards of private water companies. The Boards of Directors or Management Boards of larger water companies would typically have expertise from either the technical or management side of the water business. For example, one board that we examined had 5 of 9 board of directors who had come up through the ranks of the water industry prior to appointments on the board. This ensures that the oversight of the management of operations throughout their portfolio of contracts is technically able to judge the level of quality of the service being delivered. They are charged with the responsibility to ensure that the private company thrives.

The point should also be made that non technical directors drawn from the fields of management and finance also add depth and balance to the technical representatives on the Board in ensuring that health, safety and environmental issues receive strong consideration.

As a first consideration we would conclude that the latter model of oversight carries a higher

degree of professional competence than the government model. As a result, it is positioned, from a governance perspective, to achieve a higher quality operation and greater assurance of water quality provision.

The second consideration is how a private sector evaluates and manages risk versus a public sector provider. Anything that jeopardizes a private company's ability to perform is considered a risk. Inadequately trained staff, malfunctioning equipment, faulty infrastructure and so on are unacceptable risks in the business of private sector water operations. So referring back to Prof. Cameron's findings, those characteristics of systems that are more likely to ensure good quality operations, are the factors that if mismanaged create risk. Risks are minimized at every opportunity to ensure the integrity of the service being offered. Operations and standards are monitored on an on-going basis to ensure that top performance is being achieved and that the potential for failure is minimized or eliminated.

(Risks in the public sector are often not given the same consideration. There is an inherent cost to any organization that assumes risk - be it public or private. Increasingly in discussions being conducted by governments looking at "value for investment" considerations in many countries, risk is often not quantified as one of the costs being borne by government and it should be. When the public sector delivers a service, either directly or through an agency of the government, risk is being assumed and should be valued and treated as an expense of operation.)

Performance contracts which penalize non-performance result in financial loss. Catastrophic failure, such as feeding contaminated water into a municipal distribution network resulting in deaths, would result in bankruptcy. Because the company's very survival is based on its performance, the focus on service quality is sharpened.

Consistent with the objective to reduce and minimize risks while at the same time building efficiencies into their operations, many private water companies invest heavily in research and development activities which bring improvements on a technical and operational level to all operations throughout the network of contracts worldwide. Mr Deb Shewfelt, Mayor of Goderich, Ontario accompanied CCPPP to the July 5, 2001 Technical meeting of the Inquiry and made the point that when his municipality articulated what it felt it needed to ensure that high quality water would be available for its citizens, access to the best technology and research available rated very high on their list. Running the municipal water system themselves meant operating in isolation without the benefit of immediate access to new technologies and to new technical information. Many of the larger water companies have that capacity within their organizations.

These two sets of factors, the nature of enterprise and the management of risk through all factors including governance, research and technology, training of staff, and so on, in combination compel private sector operations somewhat differently than public sector operations and bring benefits to municipalities that have selected private sector partners. This is not to say that other factors, for example political accountability*, are not a compelling driver to municipally operated systems but rather that the factors that drive private companies are perhaps more transparent in as much as their objectives are extremely clear - to thrive, to

maintain a reputation as a high level performance company from the users' perspective, to establish a growing client base based on past performance and to get a return on an investment.

Clarification of what a private operation means to the municipality

There is a great deal of misinformation about what it means to involve a private sector company in a municipal operation. The following clarifies some of the more common myths that are raised by opponents of PPP.

*It should be noted that Mayor Shewfelt of Goderich made a representation before the Technical Hearings of the Inquiry on July 5, 2001 and submitted that political accountability is in no way diminished when contracting a service provider over delivering the service directly.

Water Rates

Let us examine what an operating contract is versus what it is not. First, it does not take away any ability of the public sector to set the water rates. That responsibility falls within the domain of the public sector and resides there as their sole responsibility. On a long term contract, water rates may well be determined for the entire length of the contract and therefore provide predictable long term certainty about the costs being allocated to each household barring any unforeseeable circumstances. They are established by the public sector and politically determined by the public sector.

Ownership of the Water Related Assets

Secondly, a public - private partnership (as opposed to the privatization model) does not take the ownership of the facility out of the hands of the public sector. Most commonly in North American models, the public sector continues to own the physical asset and depending upon the terms of the contract, determine in partnership with the private sector the level of investment in the capital plant and technology to keep the plant in a good state of repair.

In some contracts, this would be the responsibility of the private sector and the contract would specify the performance standard to be met on the condition of the plant.

Impact on Existing Labour Force

Thirdly, it does not mean that all the municipal / public - utility staff currently operating the plant would be fired and that the private operator would bring in staff from outside to operate the plant. Logic would dictate and practice would confirm that the people who best know the plants are the ones who currently operate them. Efficiencies come through increased training, technological improvements, procurement practices, etc. The protocol in the industry is to transition the bulk of staff (in many cases all of the staff) over to the private sector organization

maintaining similar benefit packages to those offered by the public sector and often maintaining the pension plan through arrangements made with the public pension system such as OMERS in Ontario. Labour has not proven to be the source of the savings achieved in most operations in North America.

Related to this is the misunderstanding voiced by a number of union participants at the technical meetings that the operator brings in people to staff the plant from outside therefore suggesting that these people are not people "from the community - not your neighbours".

This is a misunderstanding. The private sector would have no reason to import people from outside, nor would they be likely to want to incur the expense of relocations. The plant workers live in the community. Chances are the majority of them are the same people who worked in the plant when it was a publicly operated facility. To suggest that "outsiders" take over and therefore are not committed to the plant is erroneous in all respects.

Control of the Water Delivery System

Thirdly, opponents of public-private partnerships in water operations would suggest that there is a loss of control to the municipality when a private operator takes over. This is not factual. Mayor Shewfelt explained in detail his council's considerations in this regard before entering into a long term operating contract with a private supplier for the Goderich system. He concluded by saying that in fact he believed that there is more control using a private sector operator than a public operator because the contractual agreement between the supplier and the provider specifies the exact expectation of the municipality on the private sector, something that would not be articulated as well with your own staff.

Furthermore, penalty provisions are outlined in detail should a supplier not perform at the level specified within the contract. Again, such clear guidelines do not exist with an in-house provider. Non-performance remedies, in any case even if they were contemplated to apply to a public operator, would fall squarely back on the same municipality. Many would suggest that the existence of a clearly written contract with a clear set of penalties for non - performance make private sector operations more accountable than public systems and more transparent.

Free Trade Issues

Opponents of PPP have recently made a concerted effort to distort the terms of international trade agreements to suggest that the contracting of private operators in this sector (investors in the language of the agreements) can impact a municipality (sub-national in the language of the agreements) so that they lose control of their ability to manage the contract, to make changes to conditions in the terms under which the contractor operates, to make changes in the standards (for example water quality standards provincially determined), etc.

A separate submission to the Inquiry will be made on behalf of CCPPP in this regard. Suffice to say that CCPPP has been in extensive discussions with the Department of Foreign Affairs and

International Trade (DFAIT), Industry Canada, numerous law firms with international trade agreement expertise and concludes that there is no substantive evidence to give credence to these allegations. They distort the intent of the agreements (specifically the intent of Chapter II of the North America Free Trade Agreement) and endeavor to create an atmosphere of uncertainty in doing business with international suppliers. Based on all information and expert advice being received by CCPPP, these assertions should be recognized for their true intent. DFAIT has embarked on a cross Canada tour of meetings with the municipal level to clarify the agreements and to satisfy concerns that may have been raised by the opponents of free trade.

Conclusions

There have been demonstrable successes in the private delivery of water throughout the world and more relevantly in North America. These partnerships can take on a number of characteristics depending on the needs of the region or community. In the case that the community requires improvements or development of infrastructure (plant, distribution system, etc.) and lacks the financial capacity to address the problem, the private sector can participate as a **financing partner**. This in combination with **Design/Build expertise** has proven to deliver infrastructure well under typical costs achieved by the public sector through traditional procurement. When the objective of the public sector partner is to ensure the quality of operation, the private sector can act as the **systems operator** within the publicly administered system. The various models are outlined on pages 4 through 7 in our submission dated January 30, 2001 which is posted on the Walkerton Inquiry website.

The Canadian Council for Public-Private Partnerships encourages those charged with the responsibility to look to improvements in the future model of service delivery in water in Ontario to consider the greater use of public - private sector models for the benefits that they have proven to bring in financing, design, build and operations.